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INVESTMENTS PLACEMENTS

RESEARCH DEPARTMENT

ROCKOWER OF CANADA LIMITED

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ROCKOWER OF CANADA LIMITED

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Current Price	Earnings per Share 1967	Earnings per Share 1968 (est.)	P/E on 1968 (est.)	Dividend	Yield
$14	$0.87	$1.00	14.0	$0.40	2.86%

SUMMARY AND RECOMMENDATION

Rockower of Canada operates in one of the fastest growing industries in Canada, the non-food merchandising discount field. Its growth in the past has been closely related to the expansion of the Rite-Way and Allied Towers chains of discount department stores. Today these two chains are part of the Oshawa Wholesale organization, one of the most dynamic in Canada.

Further, the company has a good financial position and a strong management team and is now in a position to expand more rapidly either in its present field of endeavour or in related areas through acquisitions. It is, therefore, reasonable to expect that the company's sales growth over the next few years will compare favourably with that of the last five years.

Concurrently, there is still further room for profitability improvement and earnings growth will probably continue to be faster than sales growth. On balance we think earnings per share gains of about 15% per annum over the next few years is a reasonable expectation.

The common shares of Rockower are currently selling at $14, or a multiple of 14.0 times our earnings estimate of $1.00 a share for 1968 and yield 2.86% based on the current $0.40 dividend. This multiple appears too low both on the basis of the company's past record and in view of its earnings prospects. Even the relatively low degree of marketability (there are 828,420 common shares outstanding of which some 600,000 are closely held) is not a sufficient reason for this low multiple. We, therefore, believe that an upward adjustment would be justified and are confident it will take place once investors realize the investment merits of this situation.

The shares of Rockower thus seem to offer an unusual combination of minimal downside risk and considerable upside potential. In addition, Rockower offers an above average yield for its industry group. These shares are strongly recommended for their capital appreciation potential and growing income.

THE COMPANY

Rockower of Canada Limited operates Men's and Boy's Wear departments leased in 23 Allied Towers and one Savemart discount department store in Ontario (19) and Quebec (4). In addition, a Maverick store is operated in Kingston, Ontario. The Maverick store is a Men's and Boy's apparel store that is complete in itself and occupies rented space in a shopping centre rather than in a Towers store.

The company concentrates on the most popular ranges of wearing apparel, accessories, as well as sport and work clothes. Men's wear accounts for about 65% of dollar sales while Boys' wear and Junior Boys' wear account respectively for 25% and 10%.

All merchandise sold by Rockower (approximately 60 categories, each having as much as 150 lines) is offered at prices intended to appeal to the mass market, i.e. at discounts of 15% to 20% from normal industry prices. Rockower's merchandising concept intends to appeal to 60% - 75% of the male population of any Canadian market.

In addition to its retail departments, Rockower operates Tarud Hosiery Mills acquired in December 1964. Since that date the number of knitting machines has been increased from 21 to 60, bringing the annual hosiery production capacity to 90,000 dozen pairs of socks. The mill was moved into a new and larger plant in 1967. Over 90% of Tarud's production is sold in company outlets under Rockower's brand names.

MANAGEMENT

Throughout this report the reader will find ample statistical evidence of the ability of Rockower's top management. The usual tests related to sales growth, level of efficiency, and financial strength, all compare very favourably with any other companies in this industry group.

At the lower level, buyers are assigned in rotation to various merchandise categories thus assuring continuity in this vital function in addition to giving a broader experience to the individuals. At the store level, the assistant managers are trained to occupy the position of managers in the new stores. Further, there is a group of people, equal to half the number of units operated, that are trained to become assistant managers of new leased departments.

The company's staff turnover is negligible and the majority of senior personnel graduated from the basic training mentioned above.

THE OPERATIONS

- Buying

At Rockower the buying function is completely centralized and is carried out by a group of experienced buyers. Each buyer specializes in a category of merchandise and, in this way, he is able to effectively purchase quality products at attractive prices.

The buyers are in close and constant contact with store managers through four supervisors. Each supervisor is responsible for a group of stores and maintains the flow of communication between the stores and Head Office. This is done through weekly meetings between supervisors and store managers who exchange information and ideas that are subsequently integrated with the buying and merchandising programmes.

While about 75% of the products sold by Rockower is made by Canadian manufacturers, the volume of the Import Division has become increasingly important. The company's buyers travel to the Orient bi-annually in search of new products that are manufactured exclusively to Rockower's specifications to assure highest quality. Rockower initiated its import programme about six years ago and now has achieved a very strong competitive buying position in these markets.

Products that are made in Canada are all purchased directly from the manufacturers and then delivered directly to each store, thus minimizing the amount of handling, storage cost, insurance, etc..

- <u>In-Store Operations</u>

Once the merchandise has reached the store it becomes the entire responsibility of the store manager. His responsibilities include proper presentation of the merchandise, the layout, the training of the sales force, and finally, communications with the buyers. Each store employee is trained to recognize both fast and slow moving items and more importantly to recognize the beginning and end of a trend. These findings are then reported to the buyers.

This constant effort has resulted in a highly efficient flow of merchandise, i.e. the right goods are in the stores when in demand and also in the purchase of the proper quantities. The above is readily reflected in the high number of stock turns, 9.3 times in 1967.

Rockower develops its own advertising programme in the Head Office Advertising Department and then co-operates with Towers to determine the best space allocation for each item. In other words, Towers indicates the major advertising theme and then Rockower decides on which products will be featured within this broad theme.

As will be shown later, Rockower has entered into long term agreements for the rental and the right to do business in a number of Towers stores. Each of these agreements provides for payment to the lessor (Towers) of a percentage of sales of Rockower made in the particular store. A designated portion of this percentage is to be expended by the lessor for advertising.

<u>PAST GROWTH RECORD</u>

A glance at Table I will show the excellent record of growth and profitability Rockower has had in the last five years. Sales increased at a rate of 15% per annum while net profit, because of the substantial improvement in profitability, posted average annual gains of 31%. Sales per square foot increased from \$57 to \$83.

In 1967 the company's net profit margin stood at 5.6% compared to 3.4% in 1963. This large improvement reflects better gross profit margins, a result of the import programme, and a good control over operating expenses.

The return on the average net worth also showed a material increase during the period going from 19.8% to 29.4%. This reflects primarily the higher ratio of net profit to sales and a very efficient use of invested capital. These figures differ from those included in the annual report because the latter were computed on the basis of the net worth at the beginning of the year, not on the average at the end of the year.

LONG TERM PROSPECTS

- Sales Potential

- Existing units

Rockower now operates 25 units of which 19 were opened prior to 1966. The individual performance of these stores in the future will depend on the amount of new competition settling into their trading areas but, on balance, a minimum growth of 4% to 6% per annum can be expected. The performance of these has improved since Towers and Rite-Way merged. The stores opened between the end of 1965 and the beginning of 1968 will of course experience a much faster growth over the next few years. Sales per square foot that were $83 a square foot in 1967 are thus expected to continue to improve.

- New leased departments in Towers

An additional unit was opened in North Bay in March of this year and three more currently under construction will be opened before the end of the year. This will bring the number of concessions operated in Towers stores to 26 at the end of the year.

In subsequent years we expect that a minimum of three units will be added each year. Sites for 1969 expansion in the Towers chain have already been secured and plans for 1970 are nearing completion.

These concessions are operated under long term leases. The leases on 14 of the departments, including the renewal options, will expire between 1977 and 1979. On most of the other concessions the leases will expire between 1983 and 1988. Further, Rockower has the first right of refusal for Men's and Boys' wear departments in all future stores opened by Rite-Way or its successor company, Allied Towers.

The leases call for a rental of 11% on sales for the older units (14) and 12% for more recent openings. This percentage may appear high but include: cashiering, advertising, store management, wrapping and maintenance. In addition, there is no escalation clause to compensate the landlord for increased property taxes.

- Concessions in other store organizations

At present, only 2 departments are operated in stores other than Towers' stores. One is operated in a Savemart and the other, Maverick, is a leased store in a shopping center.

The association with Savemart has been profitable but this concern has no plans for expansion at the moment.

As far as the Maverick store is concerned it has been opened as a pilot unit and this area is presently being studied as a possible avenue of expansion.

- Summary - Sales Potential

Based on the remaining potential of existing units and current plans in relation to new openings, it would appear reasonable to anticipate a future sales growth comparable to the last five years experience, i.e. close to 15% per annum.

Further, in view of the company's strong financial position and management's desire to diversify, this expected sales growth could be further supplemented by acquisitions.

- Profit Potential

As pointed out earlier Rockower has already achieved a very high level of profitability by industry standards. Among the other major non-food merchandisers, Zeller's has the best net profit margin i.e. 4.6%.

Rockower's gross profit margin is likely to improve further because the percentage of imports is still rising moderately and, more generally, because of a more efficient merchandise-mix resulting in still higher volume.

At the operating level expenses are expected to continue to increase but not as fast as sales. On the other hand, present facilities and management can easily handle a much larger volume so that overhead expenses as a percent of sales should not change significantly.

On balance then we think that the ratio of net profit to sales can be further improved from the present level of 5.6% to possibly 6.0% over the next few years.

FINANCIAL POSITION

The company's financial position is strong. It has a cash flow from operations on the order $800,000 of which some $300,000 is needed to pay dividends. The difference is more than ample to carry out current expansion plans.

Rockower's Balance Sheet is free of long term debt or preferred share capital. The equity base now amounts to $2,664,120 and can be broken down as follows: retained earnings (65%), common share capital (28.4%) and contributed surplus (6.6%). Further, the company has no need or intention to raise capital at this point.

The working capital ratio as of December 30, 1967 was 2.8:1 but this is not a true reflection of the strength of Rockower's working capital position. In fact if it was profitable to do so the company could pay its account payables out of its temporary cash investments and the ratio would then improve to almost 7.0:1.

OUTLOOK FOR 1968

For the first 13 weeks ended March 30, 1968 Rockower shows an increase of almost 20% in sales to $2.1 million and a net profit improvement of 26.9% to $49,953

or $0.06 a share. The first quarter however usually accounts for only a small proportion of total sales and earnings for the year and for this reason is not necesssarily indicative of the results for the whole year. Nonetheless, we understand that these favourable trends were maintained in April.

In view of the first quarter performance (which reflect continued good sales gains from the older units and the results of the four new stores opened late last year) and the planned openings for 1968 we would expect another healthy sales increase this year.

Given this increase in sales, we expect a further improvement in the net profit margin. We estimate 1968 earnings at $1.00 a share, an increase of 15% from the $0.87 realized in 1967.

ROGER PAQUETTE
MONTREAL, MAY 1968.

TABLE I

ROCKOWER OF CANADA LIMITED
FIVE YEAR RECORD OF GROWTH AND PROFITABILITY

YEAR ENDING DECEMBER 31	1963	1964(1)	1965	1966	1967	COMPOUND ANNUAL GROWTH RATE
Sales ($000)	7,253	8,568	10,080	11,502	12,842	15.4%
Operating Profit Before Depreciation and Interest ($000)	534	836	1,138	1,220	1,560	31.0%
Net Profit After Taxes ($000)	244	356	507	615	719	31.0%
Earnings Per Share (2)	$0.29	$0.43	$0.61	$0.74	$0.87	32.0%
Operating Profit Margin	7.4%	9.7%	11.3%	10.6%	12.1%	
Net Profit Margin Before Taxes	6.9%	8.9%	10.6%	10.2%	11.7%	
Income Tax Rate	51.4%	53.3%	52.5%	47.6%	52.2%	
Net Profit Margin	3.4%	4.2%	5.0%	5.4%	5.6%	
Return on Average Net Worth	19.8%	25.4%	30.7%	30.5%	29.4%	
Inventory Turnover	7.9x	9.2x	10.0x	9.6x	9.3x	

(1) The subsidiary Tarud Hosiery Mills Ltd. was consolidated for the first time in 1965.

(2) For 1966 and prior years the earnings per share reported were adjusted to reflect the conversion into common shares of the preferred shares previously outstanding and the subsequent 3-for-1 split.

ROCKOWER OF CANADA LIMITED
COMMON SHARES STATISTICAL DATA

Price (1)		1963	1964	1965	1966	1967
- high	$	3.04	3.67	5.67	6.50	11.75
- low	$	1.33	2.58	3.42	5.33	6.00
E.P.S. (2)	$	0.29	0.43	0.61	0.74	0.87
P/E						
- on high		10.5	8.5	9.3	8.8	13.5
- on low		4.6	6.0	5.6	7.2	6.9
- on average		7.5	7.2	7.5	8.0	10.2
Dividends (3)		0.20	0.20	0.20	0.24	0.34
Yield						
- on high	%	6.58	5.45	3.53	3.69	2.89
- on low		15.04	7.75	5.85	4.50	5.67
- on average		10.31	6.60	4.69	4.09	4.28

(1) Prices prior to 1967 are for the preferred shares. All these preferred shares have now been converted into common shares and split 3-for-1 in 1966.

(2) Ajusted pro-forma earnings per share reflecting the conversion of the preferred shares into common shares and the 3-for-1 split mentioned above.

(3) Prior to 1966 the dividend reflects the rate paid on the preferred shares than outstanding.